

GAO

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Readiness, Committee on Armed
Services, House of Representatives

May 2009

MILITARY HOUSING PRIVATIZATION

DOD Faces New
Challenges Due to
Significant Growth at
Some Installations and
Recent Turmoil in the
Financial Markets



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Why GAO Did This Study

In response to challenges the Department of Defense (DOD) was facing to repair, renovate, and construct military family housing, Congress enacted the Military Housing Privatization Initiative in 1996. The initiative enables DOD to leverage private sector resources to construct or renovate family housing. As of March 2009, DOD had awarded 94 projects and attracted over \$22 billion in private financing. DOD plans to privatize 98 percent of its domestic family housing through 2012. Since GAO's last housing privatization report in 2006, major force structure initiatives have placed new demands on DOD for housing.

GAO was asked to assess (1) the progress of DOD's housing privatization program, (2) the occupancy rates of the housing projects, (3) the impact of various force structure initiatives and DOD's efforts to mitigate any challenges, and (4) the effect of financial market turmoil on some projects. To perform this work, GAO visited 13 installations with privatization projects; analyzed project performance data; and interviewed DOD officials, real estate consultants, and private developers.

What GAO Recommends

GAO recommends that DOD provide more current information on investment caps and the impact of the current financial market on projects in its semiannual report to Congress. In response to a draft of this report, DOD concurred with our recommendations.

To view the full product, including the scope and methodology, click on [GAO-09-352](#). For more information, contact Brian Lepore at (202) 512-4523 or Leporeb@gao.gov.

MILITARY HOUSING PRIVATIZATION

DOD Faces New Challenges Due to Significant Growth at Some Installations and Recent Turmoil in the Financial Markets

What GAO Found

DOD has made significant progress since 1996 to remove inadequate family housing from DOD's inventory by transferring these homes to developers, but it will be several more years before all of these inadequate houses are either replaced or renovated. Developers had replaced or renovated about 67 percent of the inadequate privatized housing as of February 2009.

While about 70 percent of military housing privatization projects are exceeding DOD's expected occupancy rate of 90 percent, each service has some projects below this rate. Some privatization projects with occupancy rates below 90 percent are challenged to generate enough revenue to fund construction, make debt payments, and set aside funds for recapitalization, which could negatively affect the condition and attractiveness of privatized homes and make it harder to compete with other homes in the community.

Base realignment and closure actions, overseas rebasing, Army modularity, and grow-the-force initiatives are challenging DOD's ability to provide family housing at some installations, and the services are taking steps to mitigate the challenge. Among other measures, Army developed an approach where an already awarded project is retrofitted with a new or another already awarded project. Once retrofitted, Army's total investment in the developer carrying out the projects must stay below a certain percentage of the capital costs of both projects combined, not a percentage of each project separately. This practice often results in DOD investing additional funds towards retrofitted projects. The House Appropriations Committee directed DOD to report on the status of each privatization project underway on a semiannual basis. However, DOD's most recent semiannual report did not include information on the retrofitting model it is using for certain projects. Including information on the changed status of privatized projects in DOD's report would assist congressional oversight of the program.

Several factors related to turmoil in the financial markets have reduced available funds for project construction, resulting in more renovations relative to new construction and reduced amenities at some newly awarded projects. First, higher interest rates in bond financing have increased the cost of some projects. Second, due to the diminished value of bond insurance, developers are having to set aside project funds to increase assurances the debt is repaid but that reduces available funds for construction. Third, financial turmoil has resulted in lower rates of return on invested funds. Consequently, as more homes are renovated given effects of today's financial markets, more recapitalization funds could be required. In H.R. Conf. Rep. No. 110-424, the conference committee expressed interest in monitoring developers' contributions to recapitalization accounts in DOD's semiannual report. However, information these effects have had on housing privatization projects was not included in DOD's most recent report. By including this information in its semiannual report, DOD could provide defense committees with a more current view of the financial market effects on these privatized projects.

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Abbreviations

DOD	Department of Defense
OSD	Office of the Secretary of Defense

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United States Government Accountability Office
Washington, DC 20548

May 15, 2009

The Honorable Solomon Ortiz
Chairman
The Honorable J. Randy Forbes
Ranking Member
Subcommittee on Readiness
Committee on Armed Services
House of Representatives

In the mid-1990s, the Department of Defense (DOD) became concerned that inadequate and poor quality housing was hurting quality of life and readiness by contributing to servicemembers' decisions to leave the military. At that time DOD designated about 180,000 houses, or nearly two-thirds of its domestic family housing inventory, as inadequate, needing repair or complete replacement. DOD believed that it would need about \$20 billion in appropriated funds and would take up to 40 years to eliminate poor quality military housing through new construction or renovation using its traditional military construction approach. The cost and time needed to eliminate poor quality housing prompted DOD to seek a new way to remedy the problem of its inadequate housing more quickly.

In 1996, Congress enacted the Military Housing Privatization Initiative,¹ which provided DOD with a variety of authorities that may be used to obtain private sector financing and management to repair, renovate, construct, and operate military family housing. For example, the legislation authorizes the secretary of a military department to make direct loans to and invest limited amounts of appropriated funds in developers² carrying out projects for the construction or renovation of housing units

¹ National Defense Authorization Act for Fiscal Year 1996, Pub. L. No. 104-106, §§ 2801-2841 (1996), codified as amended at 10 U.S.C. §§ 2871-2885.

² Section 2875 of Title 10, U.S. Code authorizes the military departments to invest limited amounts of appropriated funds in an "eligible entity." In this report, we use the term "developer" and "eligible entity" synonymously to describe the special purpose limited liability company or partnership that carries out a privatization project or projects. A limited liability company is a company in which the liability of each shareholder or member is limited to the amount individually invested. A limited partnership is a partnership composed of one or more persons who control the business and are personally liable for the partnership's debts (called general partners), and one or more persons who contribute capital and share profits but who cannot manage the business and are liable only for the amount of their contribution.

that are suitable for use as family housing to servicemembers and their families.

In a typical privatized military housing project, a military department leases land to a developer for a term of 50 years. The military department generally conveys existing homes that are located on the leased land to the developer for the duration of the lease. The developer is responsible for constructing new homes or renovating the existing homes and then leasing them, giving preference to military servicemembers and their families. Further, in a typical privatized military housing project, a limited liability company or partnership is formed for the purpose of carrying out a specific housing project or projects, and for the purposes of this report, constitutes the developer carrying out the project. If the secretary of a military department has made an investment in the limited liability company or partnership, the department may possess some decision-making authority for certain major decisions with regard to the project. While the major decisions may differ from project to project, they often include, for example, decisions to make changes in (1) the number of houses in the project, (2) the number of new homes versus renovated homes in the project, and (3) the project's financing, such as increases or decreases in the project's debt. Among DOD's housing privatization goals is the intent to minimize its role in operating military family housing. As a consequence, DOD will convey to developers houses that need to be replaced through new construction or renovation as well as houses that require little or no renovation.

DOD can also invest a limited amount of appropriated funds or other assets into a developer who proposes to carry out a project or projects. In turn, the developer uses these funds to help obtain private financing for construction or renovation. Developers obtain their funds through bank loans or military housing bonds obtained through private sector financial markets. Developers also typically obtain funds from the military services through either investments of cash or assets, such as land and homes, or from loans provided by the military services. When these homes obtained from DOD are ready for occupancy, the developer makes them available, giving preference to military servicemembers and their families. Servicemembers who choose to live in the developer's housing then use their basic allowance for housing to pay rent. Servicemembers are not obligated to live in privatized houses at the installation and may opt instead to lease housing or buy a home off the installation and use their housing allowance for that purpose. If servicemembers choose to live in the housing provided by the developer, the servicemembers then pay rent to the developer, often through the establishment of an allotment. DOD's

housing privatization program has, in effect, made privatized houses at an installation part of the local competitive housing markets. Thus once established, privatized housing at the installation operates similarly to any other private rental property business, i.e., through competition with other housing options in a given market.

As of March 2009, DOD had awarded 94 projects and turned over housing to real estate developers, who in turn have generated over \$22 billion in private sector financing to construct new housing or renovate existing housing on military installations. DOD plans to have privatized about 98 percent of its domestic housing (or nearly 219,000 houses) through 2012. The Office of the Secretary of Defense (OSD) reports its progress under the housing privatization initiative to congressional defense committees in its semiannual Military Housing Privatization Initiative Program Evaluation Plan Executive Report. This report provides information on deal structures, government costs, use of government authorities, program performance, and tenant satisfaction, among other information.

We last reported on the military housing privatization program in 2006. In that report, we recommended several areas where DOD could better manage the privatization program. We also raised concerns that lower-than-expected occupancy could cause financial stress and reduce funds available for future reinvestment.³ DOD fully agreed with three of our recommendations and partially agreed with two and stated that shortcomings identified in our report would be addressed. Since that time, DOD has awarded 42 additional projects to help achieve its goals of eliminating its inventory of inadequate family housing and has turned over operation of the housing to the developer.

In addition, DOD has begun several extensive force structure and infrastructure initiatives—such as the permanent relocation of about 70,000 military personnel back to the United States from overseas bases; the implementation of about 800 Base Realignment and Closure actions by 2011; the continued transformation of the Army’s force structure from an organization based on divisions to more rapidly deployable, brigade-based units; the planned increase in the end strength of the Army and the Marine Corps by a combined 101,000 military members; and the planned

³ GAO, *Military Housing: Management Issues Require Attention as the Privatization Program Matures*, [GAO-06-438](#) (Washington, D.C.: April 28, 2006).

drawdown of troops from Iraq—all of which will place new demands on DOD to provide affordable and adequate housing for servicemembers and their families at several installations expecting significant growth in military personnel numbers.

You asked us to review DOD's military housing privatization program and to determine the impact of the military's force structure changes and the recent turmoil in financial markets on DOD's housing privatization program. This report: (1) assesses the progress of DOD's military housing privatization program in eliminating inadequate family housing; (2) evaluates recent occupancy rates of military privatized housing; (3) identifies the impact of DOD's major force structure and infrastructure initiatives on the military housing privatization program and actions the services have taken to mitigate any challenges; and (4) assesses the effect of turmoil in financial markets on recently awarded military housing privatization projects.

To address these objectives, we reviewed relevant documentation including DOD and service guidance on the implementation of the military housing privatization initiative, project progress and performance reports developed by the services, and prior GAO reports. To assess progress of the program and occupancy rates, we obtained performance data on each of DOD's privatization projects awarded as of the time of our work. We visited 13 military installations with established privatized housing projects. We selected these installations because they had established privatization projects, represented each of the military services, or fit certain criteria such as expecting increases in housing needs due to DOD's force structure initiatives. At these installations, we interviewed base commanders, project managers, and developers' representatives to discuss any challenges experienced in managing their privatization projects, any mitigation efforts planned or underway, and the impact of the economic environment in 2008 and early 2009 on their projects. Our analysis of the 13 installation visits cannot be generalized to other military housing privatization projects. We also interviewed officials from the Office of the Secretary of Defense and the services' offices responsible for the military housing privatization program. Furthermore, we interviewed the Army and Air Force's real estate consultants on the impact of turmoil in the financial markets on recently awarded housing privatization projects and the overall program. Although we did not independently validate DOD's construction, renovation, or occupancy data, we compared these data to data presented in the semiannual report to the congressional defense committees. We also discussed with these officials steps they have taken

to ensure reasonable adequacy of the data. As such, we determined the data to be sufficiently reliable for the purposes of this report.

We conducted this performance audit from April 2008 to April 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Further details on our scope and methodology can be found in appendix I.

Results in Brief

DOD has made significant progress since 1996 in removing inadequate military family housing from its inventory through its privatization program, although it will be several more years before developers are able to replace or renovate all of the inadequate houses. Through fiscal year 2009, DOD plans to have privatized over 197,000 houses. According to DOD, it will have transferred all inadequate family housing from its inventory and placed it in the developers' inventory by the end of fiscal year 2009. While the transfer will have removed these homes from DOD's inventory, actual replacement of inadequate homes through new construction or renovation will take several more years. As of February 2009, developers had completed the construction or renovation of about 67 percent of the inadequate transferred homes.

Occupancy rates for most military family housing privatization projects are exceeding DOD's generally expected rate of 90 percent, although each service had some projects below the expected rate.⁴ Occupancy is an important factor in generating sufficient revenue from the military housing privatization projects to ensure that the developer can make debt service payments, effectively operate and maintain the homes, and provide

⁴ According to DOD, a generally expected occupancy rate during a project's initial development period, when many homes are being constructed or undergoing renovation is usually around 90 percent of the homes available. However, this generally expected rate is only a broad indicator of potential financial stress and is not meant to be a strict metric for determining the financial stability of each project, as each project has its own unique target occupancy rate that may be either above or below 90 percent. For example, a project with an occupancy rate below 90 percent may not be experiencing any financial difficulty as its specific target rate may have been below 90 percent. Likewise, a project with an occupancy rate above 90 percent may experience financial difficulty if it is not meeting its specific expected rate.

management fees. The military services and OSD generally consider an occupancy rate below 90 percent to be an indicator that triggers closer monitoring of a project's financial health. When triggered, DOD monitors other factors such as operating income, home construction progress, and the financial ability of the developer to make debt payments and pay operation and maintenance expenses. Our analysis of DOD's occupancy data as of September 2008 shows that about 70 percent of DOD's privatization projects were able to maintain occupancy rates of 90 percent or more, with the Air Force having the highest percentage of projects below the 90 percent expected rate (12 out of 29 projects, or 41 percent). Some privatization projects with occupancy rates below 90 percent are less likely to be able to generate enough revenue to fund home construction, make debt payments on borrowed funds, set aside funds for maintenance and other renovation of the homes, and provide reasonable management fees for the developer. For example, lower-than-expected occupancy rates at the Wright-Patterson Air Force Base project in Ohio have not generated sufficient revenue to permit the developer to pay all needed expenses. According to the Air Force, if occupancy rates do not increase, the developer is unlikely to generate sufficient funds to invest in and maintain the quality of the privatized housing over the life of the project. In that event, the homes' condition is likely to worsen over the long term, potentially increasing the difficulty of attracting servicemembers and their families as tenants if off-installation housing options are seen as more attractive or affordable.

Several force structure and infrastructure initiatives are compounding DOD's and the developers' challenges in ensuring that affordable and adequate military family housing will exist when needed. However, the services are acting to mitigate the challenges. DOD is implementing base realignment and closure recommendations, returning some military forces based overseas to defense installations in the United States, converting Army units to modular brigade combat teams under the Army modularity initiative, and increasing the size of the Army and Marine Corps force structure. Army officials told us that the planned growth at some installations was exceeding the pace at which military family housing is being made available through new construction or renovation, potentially meaning that adequate family housing on the installations would not be available when needed. To increase the pace of new construction or renovation, the Army has programmed nearly \$600 million in fiscal years 2008 and 2009 to be made available to developers who are working on five already awarded privatization projects. The Army believes that its increased investment in the five projects will make it easier for the developer to obtain additional financing to build or renovate enough

houses to meet the expected increase in housing demand. Further, the Army has in some cases “retrofitted” projects after financial closing and actual housing turnover to the developer. The military housing privatization initiative limits a service’s investment in a developer to not more than 33 percent cash, or 45 percent if land or facilities are all or part of the investment, of the capital cost of the project, or projects that the developer proposes to carry out. When an already awarded project being carried out by one developer is retrofitted with either a new project or another already awarded project, the Army’s total investment in the developer carrying out the now-combined retrofitted projects must stay below a certain percentage of the capital cost of both projects combined, not a percentage of each project separately. However, had those projects not been retrofitted, in some cases, the amount of funds allocated towards one pre-retrofitted project might have exceeded the statutory cap. For example, the Army is considering retrofitting a project located at Fort Bliss, Texas, that is near the limit with a project at West Point, New York, which is well below the limit. By retrofitting these two projects, the Army’s total cumulative percentage investment in the developer carrying out the retrofitted projects would remain below the statutory cap. However, DOD would be investing additional funds into its retrofitted projects. For example, Army officials told us that the total investment towards the Fort Bliss phase may increase by about \$77 million, which, if the projects were not retrofitted, would exceed the allowable statutory investment cap for the Fort Bliss phase alone. Army’s retrofitting practice, as described by Army and OSD officials, appears to be consistent with Section 2875 of Title 10, U.S. Code. To assist in congressional oversight of the housing privatization program, the House Report accompanying the Military Quality of Life and Veterans Affairs, and Related Agencies Appropriations Bill of 2006 directed DOD to report on the status of each privatization project underway, on a no less than semiannual basis. Although Army officials have stated that this is a model that they have used and intend to use for future projects, DOD’s most recent semiannual report to congressional defense committees did not include information on the retrofitting model it is using for certain projects. Including information about the changed status of projects that have been retrofitted, as the congressional defense committees have requested, would assist congressional oversight of the program. Thus, we are recommending that DOD include, for each retrofitted project, an explanation of this practice and information on DOD’s total investment in the retrofitted project in its semiannual status report to the defense committees.

Several factors stemming from the recent turmoil in the financial markets have reduced available funds for home construction, resulting in a larger

proportion of renovations relative to new construction and reduced scope and amenities at some newly awarded military family housing privatization projects. First, developers have had to pay higher interest rates recently as a result of a reduced pool of investors interested in purchasing military housing privatization bonds and more restrictive underwriting criteria for the remaining investors, resulting in these developers having less money to spend on new construction or renovation. For example, the developer of the Army's Fort Lee privatization project in Virginia told us that when the project went to financial closing, the amount of principal the developer was eligible to borrow was reduced by \$10 million because of increased interest costs to sell military housing privatization bonds to raise funds for home construction. The developer told us this resulted in building 97 fewer new homes and renovating more homes instead. Second, we were also told by service officials that credit rating agencies have downgraded the ratings of firms that insure military housing bonds, thus diminishing the value of buying the bond insurance used to minimize the impact of default or nonpayment. Consequently, OSD and service officials told us that due to the credit rating downgrades of firms that insure bonds are causing developers to have to set aside cash in reserves to help provide assurances that the project's debt will be repaid in the event the developer cannot make debt payments and alternatives to cash funding are no longer available to satisfy debt service reserve requirements. This in turn is reducing the amount of funds available for construction, according to defense officials. Collectively, both higher interest rates and the lack of alternatives to cash funded debt service reserves have resulted in less construction funds than planned for the Army's Fort Jackson, South Carolina project. In this case, the Army agreed to allow the developer to reduce the number of planned renovations resulting in these homes receiving no work. Third, current turmoil in the financial markets has resulted in lower returns on investment from the developers' holding of project funds in various interest-earning investments until needed for construction. Since interest earnings is one of the sources of revenue that provide income to the project to pay for operations, construction, and future recapitalization, lower-than-anticipated interest earnings can affect the financial health of a project. Also, lower returns on investment have led to less money being available for new construction or renovation, which in turn could lead to reductions in the scope of some projects. For example, the Air Force is projecting a revenue shortfall for its Tri-Group family housing privatization project comprised of Los Angeles Air Force Base, California; Peterson Air Force Base, Colorado; and Schriever Air Force Base, Colorado, due to the difference in return rates on invested funds. As a result, the Air Force is negotiating with the developer a number of changes such as eliminating two community centers and some

new housing to offset the lower than anticipated investment earnings. At the same time, changes in project scope can affect the financial health of projects through lower occupancy, which would consequently reduce rental income for the developer if more renovated homes or fewer project amenities make the houses less marketable when compared with competing housing options off the installation and generate fewer funds in reserve accounts for recapitalization purposes. As such, the conference committee has expressed interest in monitoring the Military Housing Privatization Initiative program and receiving information about the contributions of developers to the recapitalization accounts of each ongoing family housing privatization project in DOD's semiannual progress report on the program. As more homes are renovated rather than constructed, as a result of the turmoil in today's financial markets, privatization projects with a large number of renovations could require more recapitalization funds in the long term and possibly sooner than expected. However, this information on newly awarded privatization projects was not included in DOD's most recent semiannual status report to Congress in January 2009. Including this information in DOD's semiannual report would provide Congress with a more current view of the program and enhance congressional defense committees' ability to monitor the services' efforts to provide military servicemembers with quality housing over the life of each project. Thus, we are recommending that DOD include information in its semiannual status report to congressional defense committees on the effects current conditions in the financial markets are having on housing privatization projects.

In written comments on the draft of this report, DOD agreed with both of our recommendations. DOD's comments are reprinted in appendix II of this report. DOD also provided technical comments on a draft of this report, which we incorporated where appropriate.

Background

Congress established the Military Housing Privatization Initiative in 1996 to ensure adequate military family housing was available when needed by renovating existing inadequate housing and constructing new homes on and around military bases more rapidly than was possible using traditional funding and military construction methods. Under the initiative, Congress provided DOD with a variety of authorities that may be used to obtain private sector financing and expertise to repair, renovate, and construct military family housing, including :

- *Real estate tools:* The secretary of a military department may convey or lease existing DOD property or facilities to developers for the purpose

of using that property to provide housing suitable for military servicemembers.

- *Investment tools:* The secretary of a military department may invest limited amounts of appropriated funds in a developer carrying out a project or projects for the acquisition or construction of housing units suitable for use as military family housing.
- *Financial tools:* The secretary of a military department may make direct loans to a developer or may guarantee a loan made to a developer if the proceeds of the loans are used to acquire or construct houses suitable for use as military family housing.

DOD may exercise one or any combination of military housing privatization initiative authorities, which provides flexibility in the structure and terms of the transactions with the private sector. This flexibility has resulted in a number of different kinds of transaction structures using different combinations of these authorities.

In a typical privatized military housing project, the developer is a limited liability company or partnership which has been formed for the purpose of acquiring debt, leasing land, and building and managing a specific project or projects. The limited liability company is typically composed of one or several private sector members, such as construction firms, real estate managers, or other entities with expertise in housing construction and renovation. In those cases where the secretary of a military department has made an investment in the limited liability company, the department may also be a member of the limited liability company.⁵ In a typical privatized military housing project, a military department leases land to a developer for a term of 50 years. The military department generally conveys existing homes located on the leased land to the developer for the duration of the lease.⁶ The developer is responsible for constructing new homes or renovating existing houses and then leasing this housing, giving

⁵ The secretary of a military department may invest cash, housing, or in some cases, land to the developer as a government investment.

⁶ Typically, title to the houses that are conveyed and any improvements made to these houses during the duration of the lease automatically revert to the military department upon expiration or termination of the ground lease.

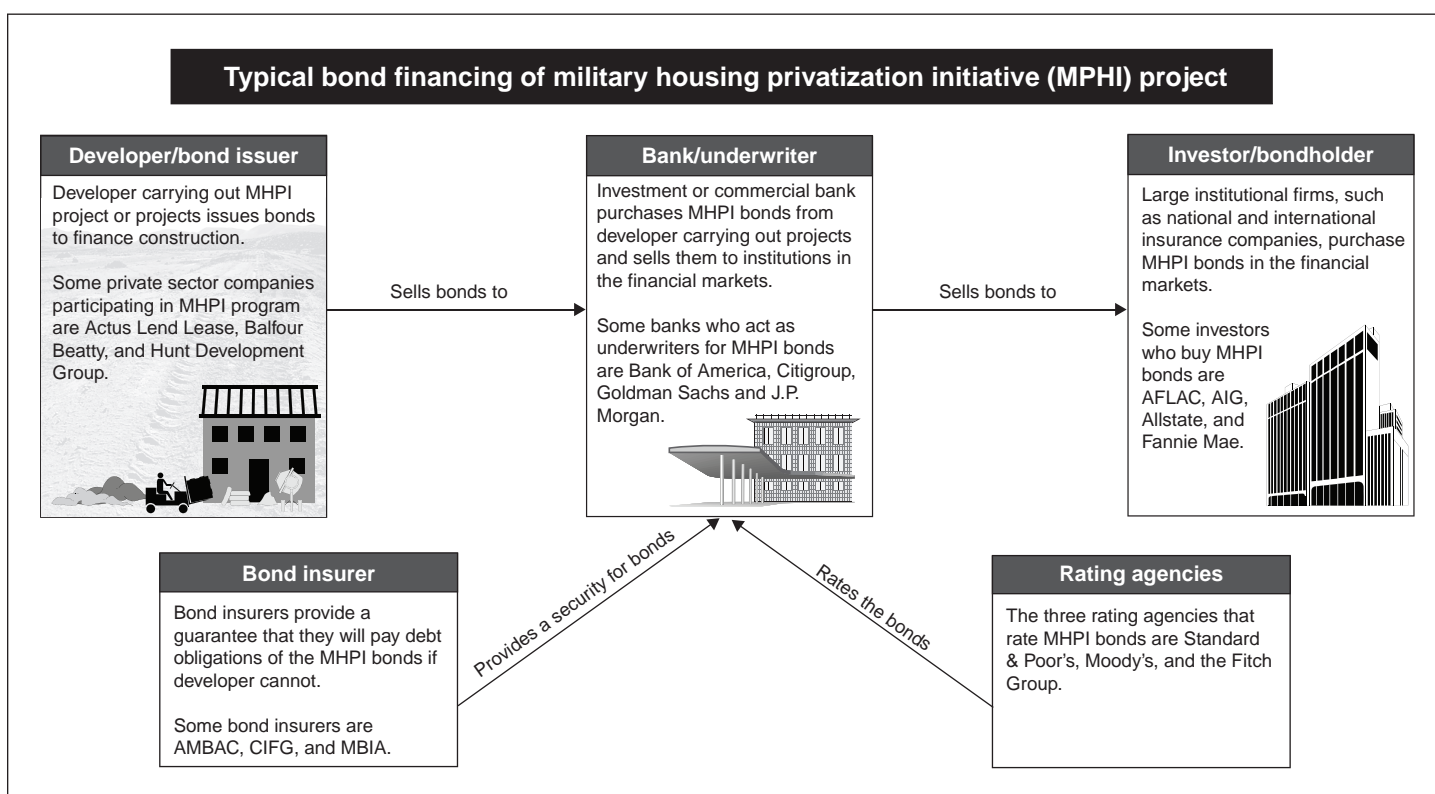
preference to servicemembers and their families.⁷ Although the developers enter into agreements to construct or renovate military housing, the developer normally enters into various contracts with design builders and subcontractors to carry out the actual construction and renovation.

Typical Financing of Military Family Housing Privatization Projects

In addition to any government or private sector investment in the developer, the majority of the project financing is obtained from financial institutions in the form of construction loans or military housing bonds. The developers issue military housing bonds in the private financial markets to fund new home construction or renovation of existing homes, with the servicemembers' basic allowance for housing serving as the primary security for the funds obtained through bonds. Although the servicemember's housing allowance is subject to the defense budget, which is supported through annual appropriations, we were told most bond investors believe it to be a highly reliable revenue stream given the history of stable congressional funding of servicemembers' housing. In addition, because developers issue military housing bonds in the financial markets, several other financial entities are involved in the process of obtaining bond financing of military family housing privatization projects, as shown in figure 1.

⁷ DOD has established at tenant "waterfall" that privatization projects can use if occupancy falls below a certain rate. Generally, after military families are accommodated, the order of the tenant waterfall is unaccompanied military personnel, active National Guard and Reserve, military retirees, federal government civilians, and lastly civilians.

Figure 1: Typical Entities Involved in Bond Financing of Military Family Housing Privatization Projects



Source: GAO analysis of DOD documents on military housing privatization initiative.

In addition to the housing bond financing obtained through the financial markets, the services can also provide some financing to the privatization projects through other approaches. On one hand, the Army and Navy have typically chosen to invest limited amounts of appropriated funds in developers carrying out projects to renovate existing housing or construct new housing for use by servicemembers and their families. On the other hand, the Air Force has typically chosen to provide direct loans to developers carrying out projects on Air Force installations. Generally, the type of government financial involvement—whether it be an investment or direct loan—determines the structure of the project's ownership. For example, because the Army and Navy typically make investments in developers, they may have a membership interest in the developer. Although the private sector company that is the managing member of the developer maintains day-to-day operational decision making and manages the project, the Army and Navy enter into an operating agreement with the managing member that describes the governance, terms, and structure of

the developer. The operating agreement will typically specify certain major decisions that must be made with the consent of the government. While these major decisions may differ from project to project, they often include, for example, certain changes to the project scope including changes in the number of houses in the project, the number of new homes versus renovated homes in the project, and the project's financing such as increases or decreases in the project's debt. Conversely, because the Air Force does not generally make investments in the developer carrying out the privatization projects but instead provides direct loans, it does not generally become a member or partner of the developer and is not part of the project ownership.

DOD contributions, either in the form of cash investments or direct loans, are often made to close gaps in construction funding that materialize when the developer is unable to obtain adequate financing necessary for the project size. Funding gaps occur when the estimated cost of the project exceeds the amount the project can support, meaning that the developer cannot obtain all the financing needed to build the project for the defense installation or installations. To maintain the needed project size, DOD can either provide a direct loan or an investment to the developer to bridge the gap between the estimated project cost and the amount of money the developer is able to obtain through the private financial markets, although this also increases the amount of appropriated funds provided to the project. DOD does not provide funds to cover the private developer's debt payments associated with the project.

DOD's Family Housing Policy and Basic Allowance for Housing

DOD's policy is to rely on private sector housing in the local communities near military installations as the primary source of family housing. As a result, about two-thirds of all military families in the United States live in local community housing and receive a cash housing allowance, known as basic allowance for housing, to help defray the cost of renting or purchasing a home. Each year, DOD sets the monthly basic allowance for housing rates. This allowance is based on the median local monthly cost of housing, including current market rents, utilities, and renter's insurance. The allowance can fluctuate from year to year as demand in some housing markets varies over time. The housing allowance is generally based on servicemembers' pay grades and whether or not they have dependents. Furthermore, while the housing allowance is calculated on the basis of the housing rental market, servicemembers may choose to apply their allowance toward purchasing a home, and are free to spend more or less than their allowance on housing. Servicemembers are permitted to keep any portion of their basic allowance for housing not spent on rent and

conversely will have to use other funds if their rents exceed their allowance.

The basic allowance for housing rates has increased since 2000 as DOD has implemented an initiative to reduce military servicemembers' out-of-pocket housing costs. However, in certain areas, higher housing allowance rates may make it more feasible for military servicemembers to consider off-base rental housing if the homes are deemed more desirable in the community or the amount of the housing allowance exceeds the cost of the rent, permitting the servicemember to keep the difference. Similarly, higher housing allowances may prompt some off-installation housing developers to directly compete with privatized housing at the installation by building more housing to compete for servicemembers as tenants. Thus, increased housing allowances and increased housing choices can provide servicemembers and their families with more housing options and potentially lead to lower rates of occupancy for privatized housing at an installation. We reported in April 2006 that increases in housing allowances have made it possible for more servicemembers to afford private housing in the local market, thus reducing the need for privatized housing at installations.⁸

When a servicemember chooses to live in a family housing privatization project, the servicemember pays rent to the developer, often through the establishment of an allotment. The rent is usually, but not always, equal to the basic allowance for housing. In turn, the developer uses the rental income to help pay for housing improvements, home maintenance and property management expenses, and other costs such as utilities and the developer's management fees. In addition, while privatized housing is meant to be an attractive alternative for military servicemembers looking for a place to live, DOD does not require servicemembers, other than certain key personnel, to live on the installation and thus in military privatized housing.

DOD Conducts Oversight of the Housing Privatization Project

Within the Office of the Secretary of Defense, the Housing and Competitive Sourcing Office, which reports to the Deputy Under Secretary of Defense (Installations and Environment), provides policy and oversight of the housing privatization program, although responsibility for implementing the statutory authority granted under the Military Housing

⁸ [GAO-06-438](#).

Privatization Initiative is primarily with the military departments. To help oversee the military housing privatization program and provide status information on project performance, OSD prepares a report, known as the Military Housing Privatization Initiative Program Evaluation Plan Executive Report, and provides it to the four congressional defense committees. This report, which is prepared semiannually for the periods ending June 30 and December 31, compiles various financial and program progress data submitted by the military services for each awarded privatization project. It provides information on deal structures, government costs, use of statutory authorities, program and financial performance, home construction and renovation progress, occupancy rates, and results of surveys on military servicemember's satisfaction with privatized housing. The congressional defense committees and OSD use this information to monitor the program's progress and conduct financial and performance oversight.

Currently, the focus of the military housing privatization program and OSD oversight is to ensure that all construction is completed on schedule and within budget, projects are financially viable and address the changing requirements of the military services, and servicemembers and their families have access to adequate, affordable, well-maintained, and safe housing. OSD credits housing privatization with greatly improving the state of its housing for servicemembers and their families. Figures 2 through 4 show photographs of older and newly constructed privatized housing at selected installations we visited.

Figure 2: Older and Newly Constructed Housing at Fort Meade, Maryland



Older privatized housing at Fort Meade, Maryland

Source: GAO.



New privatized housing at Fort Meade, Maryland

Figure 3: Older and Newly Constructed Housing at Holloman Air Force Base, New Mexico



Older privatized housing at Holloman Air Force Base, New Mexico

Source: GAO.



New privatized housing at Holloman Air Force Base, New Mexico

Figure 4: Older and Newly Constructed Housing at Navy's San Diego Complex, California



Older privatized housing at Navy's San Diego complex, California

Source: GAO.



New privatized housing at Navy's San Diego complex, California

DOD Has Made Progress in Transferring Inadequate Family Housing to Developers Although Actual Replacement Will Take Several Years

Since Congress authorized the Military Housing Privatization Initiative in 1996, DOD has made significant progress in transferring inadequate military family housing from its inventory by privatizing these homes. However, it will be several more years before developers are able to replace or renovate all of the inadequate houses as expected because developers cannot complete all needed construction and renovation at once. Developers had replaced or renovated about 67 percent of the inadequate privatized houses as of February 2009.

DOD Has Made Progress in Transferring Inadequate Family Housing to Developers through Privatization

DOD has made significant progress in transferring ownership of inadequate family housing to developers who are to replace or renovate them. Because DOD typically conveys the homes it owns on military installations to the developer for the duration of the ground lease, such homes are no longer accounted for on DOD's property inventory. At the start of the housing privatization program in fiscal year 1996, DOD identified approximately 180,000 inadequate houses based on specific criteria established by each service. Since then, DOD has used privatization as its primary means of removing inadequate houses because

it allows for more rapid demolition, replacement, and renovation of homes than DOD has stated it could do on its own. According to DOD, as of February 2009, it had privatized almost 188,000 houses and most of its inadequate family housing had been transferred out of its inventory. During the years 2009 through the end of 2012, DOD plans to privatize about 31,000 more homes, as shown in table 1.

Table 1: Actual and Projected Number of Military Family Houses Privatized

Military services	Houses privatized as of February 2009	House estimated to be privatized 2009 through 2012	Total houses to be privatized
Army	86,802	9,857	96,659
Navy and Marines	62,934	4,293	67,227
Air Force	38,168	16,903	55,071
Total	187,904	31,053	218,957

Source: GAO analysis of data obtained from OSD’s housing privatization Web site and the services.

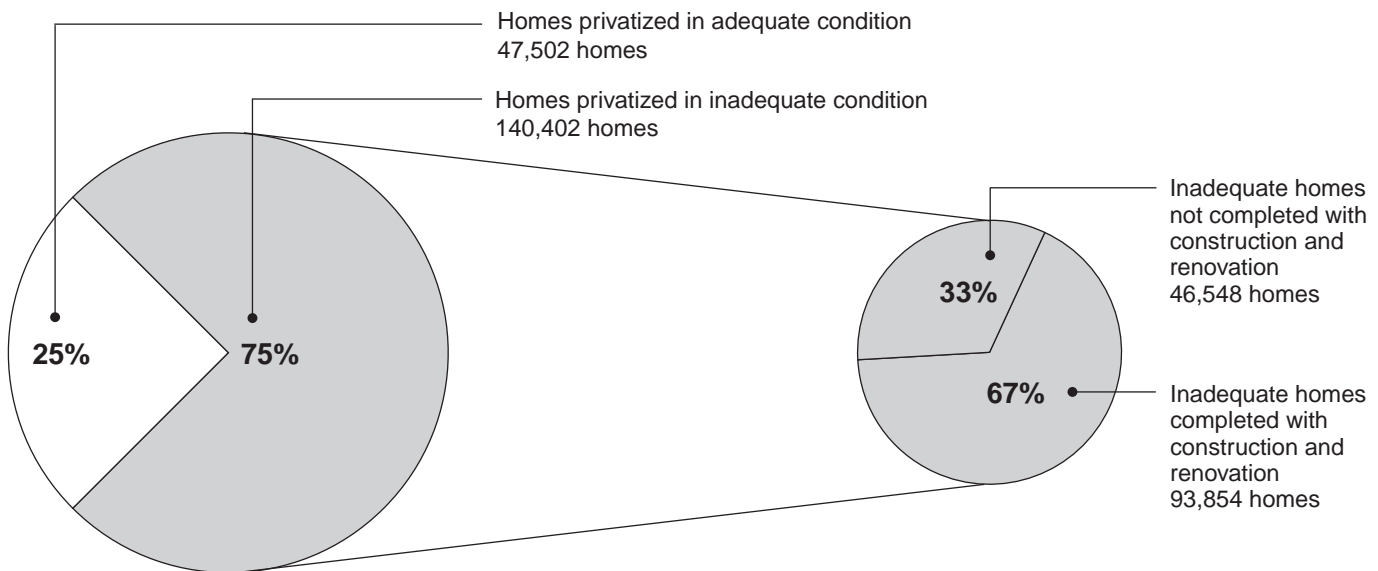
In addition, by the end of fiscal year 2009, DOD’s data shows that it plans to have privatized over 197,000 houses. At that point, according to DOD, it will have transferred all of its inadequate family housing from its inventory to developers.

Actual Replacement of Inadequate Houses by Developers Will Take Several More Years

Although DOD has transferred most of its inadequate housing to developers for the duration of the ground leases through privatization, actual replacement of these homes through new construction or renovation will take several more years. The lag occurs because developers can not complete all needed construction at the same time. According to DOD’s best available data on construction progress, housing developers had replaced or renovated about 67 percent of the inadequate houses scheduled to be replaced or renovated. Importantly, since DOD wants to transfer military family housing operations to the private sector to the greatest extent possible, some privatization projects include the transfer of houses that are adequate and need little or no renovation at the time of transfer. At the time of our report, DOD’s data show that out of 187,904 total homes privatized as of February 2009, 47,502, or 25 percent, were in adequate condition and did not need replacement or renovation. In contrast, 140,402 homes, or 75 percent, were in inadequate condition and in need of replacement or renovation. As figure 5 shows, of the 75 percent of privatized homes in inadequate condition, private developers have

replaced 93,854 of these homes, or 67 percent, with new construction or renovation.

Figure 5: Percentage of Construction and Renovation Completed by Military Family Housing Privatization Developers (as of February 28, 2009)



Total homes privatized as of February 28, 2009

 Homes in inadequate condition requiring new construction or renovation

Source: GAO analysis of DOD documents.

Although a Majority of Privatization Projects Exceed DOD's Generally Expected Occupancy Rate, Certain Projects Are Not Meeting This Rate

While the majority of DOD's privatization projects are exceeding DOD's generally expected occupancy rate of 90 percent, each service has some projects that are not meeting this rate. Our analysis of DOD's data as of September 2008 shows that about 70 percent of DOD's privatization projects had achieved the generally expected occupancy rate, while about 30 percent were below the generally expected rate. Although many of these projects are only slightly below the 90 percent rate, occupancy is an important factor in ensuring sufficient revenue generation since the developers' rental receipts are used to fund additional construction, make debt payments, invest in reserve accounts for future maintenance, and provide management fees. When a servicemember chooses to live in a family housing privatization project, the servicemember pays rent to the developer, often through the establishment of an allotment. The rent is

usually, but not always, equal to the basic allowance for housing. In turn, the developer uses the rental income to help pay for housing improvements, home maintenance and property management expenses, and other costs such as utilities and the developer's management fees. The developer cannot raise or lower the dollar amount of the member's basic allowance for housing, as DOD sets this rate each year.⁹

About a Third of Privatization Projects Are Not Maintaining Generally Expected Occupancy Rates

While the majority of DOD's privatization projects are exceeding DOD's generally expected occupancy rate of 90 percent, each service has some projects that are not meeting this rate. As of September 2008, about 70 percent of DOD's privatization projects were maintaining the expected occupancy, while about 30 percent of the projects were below the 90 percent occupancy rate. Specifically, occupancy was below the 90 percent rate in 12 of the Air Force's 29 projects; 7 of the Army's 30 projects; and 3 of the Navy and Marine Corps' 15 projects.¹⁰ This represents a decrease in the percentage of projects with low occupancy rates we found at the time of our 2006 report, at which time 36 percent of privatization projects (16 out of 44) were below 90 percent. Table 2 lists the privatization projects with occupancy rates under 90 percent as September 2008.

⁹ DOD's allowance for housing is based on the median local monthly cost of housing, including current market rents, utilities, and renter's insurance. The allowance can fluctuate from year to year as demand in some housing markets can vary from year to year.

¹⁰ Although DOD-prepared data indicates it has awarded 94 military family housing privatization projects or project phases, DOD's data on occupancy rates is for 74 projects because DOD incorporated or merged some project phases into existing projects in its reporting of occupancy rates.

Table 2: Military Family Housing Privatization Projects with Occupancy Rates below 90 Percent as of September 2008

Air Force		Army		Navy/Marine Corps	
Project name	Occupancy rate as a percentage	Project name	Occupancy rate as a percentage	Project name	Occupancy rate as a percentage
Dyess	89	Fort Polk	87	Northeast	88
Robins II	89	Fort Hamilton	85	New Orleans Complex	86
Vandenberg	87	Fort Leonard Wood	82	Southeast	84
Wright-Patterson	87	Fort Benning	82		
Tri-Group	87	Fort Rucker	81		
Hanscom	86	Fort Leavenworth	79		
McGuire/ Fort Dix	84	Fort Jackson	51		
Air Education and Training Command Group I	84				
Dover	83				
Scott	76				
Little Rock	73				
Patrick	53				
12 Air Force projects below DOD's expected occupancy rate		7 Army projects below DOD's expected occupancy rate		3 Navy/Marine Corps projects below DOD's expected occupancy rate	

Source: Service project performance reports, September 2008.

Note: Occupancy rate is the number of houses occupied divided by number of houses available. To maintain expected occupancy rates, DOD allows developers to rent to nonmilitary families. As a result, some of these projects are occupied by a mix of military families and other tenants such as unaccompanied servicemembers and nonmilitary personnel.

Although many of these projects are only slightly below DOD's generally expected occupancy rate, service officials told us they are still watching the financial aspects of these projects closely since even slightly lower-than-expected occupancy rates can lead to insufficient revenue generation to meet necessary project expenses. In such cases, DOD officials told us that they would look more closely at other indicators of the project's financial health such as operating income, home construction progress, and the ability of the developer to continue to make debt payments and pay operation and maintenance expenses.

Many factors can contribute to each specific privatization project's occupancy rate and these factors may vary from one location to another

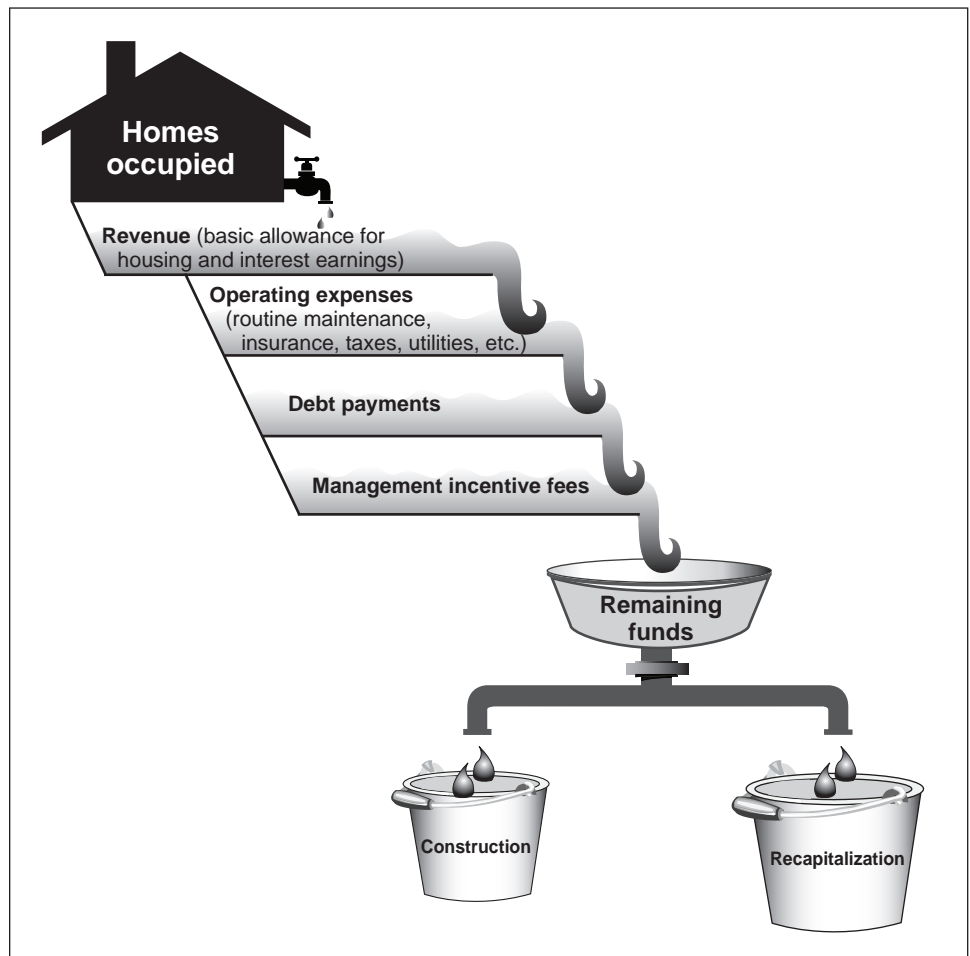
and may be specific to the location. For example, off-installation housing options in the surrounding community can influence whether military servicemembers desire to live in the military privatized housing at their base or elsewhere in the community. Specifically, the quality and affordability of both off-base rentals and for-sale housing and the nature of the off-installation communities where available housing exists are some factors that can influence a servicemember's decision where to live while stationed at a particular installation. In addition, other factors such as the quality of the military privatized housing in comparison to the competing housing options, the availability of certain amenities such as community centers and swimming pools on the installation or in the off-installation community, the location and quality of elementary and secondary schools, commuting distances, and the quality of property management service provided by the privatization project owner may influence a servicemember's decision where to live. Some examples of the reasons for below 90 percent occupancy at selected bases as of September 2008 follow:

- At the Navy's New Orleans Complex, Louisiana, occupancy was 86 percent. According to the Navy, the primary reason for this occupancy rate was military members moving away from Naval Air Station Joint Reserve Base New Orleans as a result of base realignment and closure actions.
- At Fort Hamilton, New York, occupancy was 85 percent. Army officials attribute this to last year's higher-than-anticipated 22 percent increase in the basic allowance for housing, which according to the Army, has made off-installation housing options more affordable for servicemembers and their families.
- At Fort Benning, Georgia, occupancy was 82 percent. According to Army officials, extended deployments prompted some family members left behind to vacate their on-installation privatized houses and move to be closer to other family members.
- At Fort Jackson, South Carolina, occupancy was 51 percent. This project was awarded in August 2008 and much of the existing inventory of houses transferred to the private developer was older and had not yet been renovated, making the houses relatively less attractive and marketable, according to Army officials. The Army expects occupancy rates to increase considerably as the developer replaces the older housing with newly constructed or renovated homes.

Lower-than-Expected Occupancy Can Cause Financial Distress for Some Projects

Due to lower-than-expected occupancy, some privatization projects are generating insufficient revenue to meet income projections which, in some cases, is affecting the developers' ability to fund construction, make debt payments, and provide funds for future maintenance and recapitalization. Developers generate revenue from the privatization project by renting out privatized housing at the installation to tenants, giving preference to servicemembers and their families. The member's basic allowance for housing goes directly to the developers as rent, and the developer, in turn, uses the allowance to help pay for housing improvements, home maintenance and property management expenses, and other costs such as utilities. The developer cannot raise or lower the member's basic allowance for housing, given that DOD sets the basic allowance rates each year. DOD determines these allowance rates based on the median local monthly cost of housing, including current market rents, utilities, and renter's insurance. The allowance can fluctuate from year to year as demand in some housing markets varies over time. The relationship of maintaining sufficient occupancy to generate needed revenue to maintain the project's financial health is shown in figure 6.

Figure 6: Relationship between Occupancy and Finances of a Typical Military Family Housing Privatization Project



Source: GAO analysis of DOD documents.

Note: Remaining funds mostly go to recapitalization although some funds can go to housing construction. However, developers mostly obtain housing construction financing in the private market through bonds and direct loans.

If project occupancy is lower than the 90 percent generally expected rate, then rents for the homes may not generate enough revenue to permit completion of all planned construction. For example, lower-than-projected occupancy (76 percent) at Scott Air Force Base, Illinois, was contributing to an unexpected funding shortfall. The project only generated \$14 million of the projected \$24.7 million in net operating income as of September 2008, resulting in an almost \$11 million shortfall in funds needed to

complete home construction. According to the Air Force, the supply of newly constructed homes and the growing number of available competing rental properties in the community around Scott Air Force Base has provided effective competition by providing military servicemembers and their families with numerous off-installation housing alternatives. Thus, the Scott Air Force privatization project was generating insufficient revenue to cover its expenses at the time of our report.

Lower-than-expected occupancy can affect a developer's ability to generate adequate revenue to meet income projections if rental receipts are insufficient to meet the developer's obligations, which can undermine the developer's ability to make required debt payments to repay the construction bond. This situation can also undermine the developer's ability to adequately maintain or modernize the homes when needed, potentially leading to future deterioration of the homes and an increasing inability to compete with off-base alternatives. For example, due to low occupancy (87 percent) at the Wright-Patterson Air Force Base project in Ohio, revenue was insufficient at the time of our review to fund project obligations such as debt service and management fees, thus the Air Force and developer agreed to pay these obligations with other project funds. According to the Air Force, without continued increased occupancy, the project is not expected to have sufficient funds to invest in and maintain the quality of the housing inventory over the life of the 50-year lease.

To help minimize the negative financial impact of low occupancy and maintain project revenue and financial viability, some developers have begun renting houses to parties other than military families, such as unaccompanied servicemembers, active National Guard and Reserve personnel, military retirees, federal government civilians, and in some projects, private civilians.¹¹ For example, the occupancy rate for military families has been considerably lower than expected for the last 5 years at the Army Presidio of Monterey/Naval Post Graduate School Monterey project in California. As a result, the project has been renting to personnel other than active-duty military servicemembers with families. About

¹¹ DOD has established a tenant "waterfall" that projects can use if occupancy falls below a certain rate. Generally, after military families are accommodated, the order of the tenant waterfall is unaccompanied military personnel, active National Guard and Reserve, military retirees, federal government civilians, and lastly civilians. We have been told some installation commanders have expressed reservations to private developers about having civilians living in military privatized housing, which at some installations, had resulted in the developer's reluctance to rent to civilians that can potentially further constrain generating revenue.

22 percent of the tenants at the project were not active-duty servicemembers with families as of August 2008. According to Army officials, factors contributing to low occupancy for active-duty servicemembers with families for this project included the poor condition of existing housing that had not yet been renovated and significantly higher-than-expected housing allowances, which have made it financially possible for more military families to afford housing in the surrounding community. These two factors have made it difficult for the project to maintain an occupancy rate sufficient to generate enough revenue to cover expenses. However, our analysis of DOD's June 2008 data shows that programwide, 4.1 percent or nearly 5,950 privatized homes are rented by parties other than active-duty servicemembers with families. About half of these homes are rented by unaccompanied active-duty servicemembers and active National Guard and Reserves members, while the other half are rented by military retirees, federal government civilians, and civilians.

Several Defense Initiatives Are Adding to the Challenge in Providing Affordable and Adequate Housing and the Services Are Taking Steps to Mitigate That Challenge

Several ongoing defense force structure and infrastructure initiatives, such as implementing base realignment and closure recommendations, returning some military forces based overseas to defense installations in the United States, converting Army units to modular brigade combat teams under the Army modularity initiative, and increasing the size of the Army and Marine Corps force structure, are collectively compounding the challenge DOD faces in ensuring military servicemembers and their families have affordable and adequate family housing. However, the services have taken several steps to mitigate that challenge.

DOD's Force Structure and Infrastructure Initiatives Are Increasing Family Housing Needs at Some Installations

DOD's force structures and infrastructure initiatives are leading to increasing family housing needs due to the relocation of servicemembers and their families under:

- **Grow-the-Force:** In January 2007, the President announced and Congress approved a permanent increase in the Army end strength by more than 74,000 soldiers and the Marine Corps' end strength by 27,000 Marines through the Grow-the-Force initiative over the next several years.

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- **Base Realignment and Closure:** Several Army installations will experience growth due to implementation of the 2005 base realignment and closure round. Under the 2005 round, DOD is implementing 182 recommendations which must be completed by the statutory deadline of September 15, 2011. These recommendations encompass a large number of realignments, prompting significant personnel movements among installations.
 - **Global Defense Posture Realignment:** DOD plans to realign its overseas basing structure and reduce its overseas presence by transferring about 70,000 servicemembers and civilian personnel from overseas bases to bases in the United States by 2011.
 - **Army Modularity:** The Army is undergoing a major force restructuring as it implements its force modularity, which entails converting units to brigade combat teams. Many Army installations with housing privatization projects either have received or are slated to receive one or more of these brigade combat teams.

Collectively, DOD's initiatives are affecting Army installations to a greater degree than those of the other services and are generating increased family housing requirements for certain installations that may be met with privatized housing. For example, the privatized housing requirement at Fort Bliss, Texas, has increased by about 600 houses from 6,332 houses to 6,946 houses. Fort Bliss officials are also working with El Paso city officials to increase off-base residential housing in the local community to meet the expected growth of military families stationed at Fort Bliss. According to Army officials, because the Army's growth plans are exceeding the pace at which military family housing will be made available, it will be difficult to completely meet this need by the time additional servicemembers and their families arrive.

Services Have Taken Steps to Address the Impact of Various Defense Initiatives on Their Ability to Provide Adequate and Affordable Family Housing

The services have taken or plan to take certain steps to ensure that adequate family housing exists for military servicemembers and their families. The Army plans to invest more appropriated funds into some privatized family housing projects at several installations expecting growth in the numbers of military personnel. Specifically, the Army has provided almost \$600 million more to developers carrying out five projects to provide additional project funding to meet the need for more homes. Army officials told us that the additional funding will make it easier for these developers to obtain additional financing as well. Table 3 displays the

installations at which Army is providing additional funds to developers and the amount of the funds.

Table 3: Army's Planned Grow-the-Force Investments for Military Family Housing Privatization Projects at Certain Growth Installations (Fiscal Years 2008 and 2009)

Dollars in millions			
Growth installations	Fiscal year 2008	Fiscal year 2009	Total
Fort Bliss, Tex.	\$35.6	\$127.0	\$162.6
Fort Bragg, N.C.	44.4	0	44.4
Fort Carson, Co.	98.3	103.0	201.3
Fort Lewis, Wash.	72.7	0	72.7
Fort Stewart, Ga.	0	103.8	103.8
Total	\$251.0	\$333.8	\$584.8

Source: Army.

Despite the additional funding to increase the availability of family housing at certain installations, Army's growth plans may still exceed the pace at which military family housing will be made available at some installations. This, in turn, is prompting the Army to choose to invest more appropriated funds into some privatization projects. Recently, the Army has "retrofitted" a few military housing privatization projects after financial closing and actual housing turnover to the developer. Section 2875 of Title 10, U.S. Code requires the secretary of a military department to limit the investment in an "eligible entity" to not more than 33 percent cash, or 45 percent if land or facilities are all or part of the investment, of the capital cost of the project or projects that the "eligible entity" proposes to carry out.¹² DOD officials explained that when an already awarded project that is being carried out by one developer is retrofitted with either a new project or another already awarded project, the Army's total investment in the developer carrying out the combined retrofitted projects must stay below a certain percentage of the capital cost of both projects

¹² An "eligible entity" is any private person, corporation, firm, partnership, company, state or local government, or housing authority of a state or local government that is prepared to enter into a contract as a partner with the Secretary concerned for the construction of military housing units and ancillary supporting facilities. 10 U.S.C. § 2871(5). In this report, we use the term "developer" and "eligible entity" synonymously to describe the special purpose limited liability company or partnership that carries out a privatization project or projects.

combined, not a percentage of each project separately.¹³ However, had those projects not been retrofitted, the amount of funds allocated towards any one pre-retrofitted project may have exceeded the statutory investment cap.

Army officials told us that this model has been used several times to retrofit projects, and that they plan to continue to use this model in the future. For example, the Army retrofitted a project located at Fort Sill, Oklahoma, with an ongoing project located at Fort Meade, Maryland. As a result of retrofitting these projects, the Army's total cumulative investment in the developer carrying out the retrofitted Fort Sill/Fort Meade projects was 28.8 percent, well below the 45 percent statutory cap. However, the Army's total investment towards the Fort Sill phase alone is 55.8 percent of the capital costs of that phase, which would have exceeded the allowable statutory investment cap had it not been retrofitted with the Fort Meade project. Army officials stated that they intend to continue to use this retrofitting model for future projects. For example, at Fort Bliss, Texas, and White Sands Missile Range, New Mexico, the Army cannot invest any more appropriated funds for the project after its fiscal year 2008 and 2009 investments of nearly \$163 million because it will have reached the statutory investment cap. Nonetheless, according to Army officials, the \$163 million will not be enough to ensure that adequate and affordable housing is available given the planned growth in military personnel at these two installations. Fort Bliss is expected to experience a gain of about 38,000 military families from 2005 to 2012. Thus, the Army is considering retrofitting the already awarded projects at Fort Bliss/White Sands Missile Range with one at West Point, New York, as a way to invest more into the Fort Bliss project and still be in compliance with the statutory investment cap. By retrofitting these two projects, the Army's total cumulative investment in the retrofitted projects would remain below the statutory investment cap. Army officials told us that the total investment in the Fort Bliss phase may increase by about \$77 million, which if the projects were not retrofitted, this amount would exceed the statutory investment cap. Thus, the service's overall percentage of appropriated funds invested in carrying out the retrofitted projects declines, while the actual amount of appropriated funds contributed increases. Army officials stated they developed this approach as a way to

¹³ While, prior to retrofitting, the projects were carried out by different developers, the managing member of each developer is the same private sector company (or its subsidiary).

comply with the statutory investment caps while trying to ensure that adequate and affordable military family housing is available when needed. OSD stated that it had no reason to believe that Congress intended the investment limitation to be more restrictive on projects retrofitted after award than on projects combined prior to award. Accordingly, OSD officials told us that the use of the retrofitting model represents the Army's rational use of statutory authority to invest in projects structured to optimize the use of private and public resources. The Army's retrofitting practice, as described by Army and OSD officials, appears to be consistent with Section 2875 of Title 10, U.S. Code.

In many cases, a developer is awarded a project that involves multiple installations. Of the 94 projects awarded under the military housing privatization initiative as of March 2009, approximately a third of these projects have combined privatization efforts at multiple installations under the ownership of one developer. The military services' investments in developers owning combined projects have been within statutory limitations, though the developer's allocations of funds to individual installations may have exceeded 33 or 45 percent. Further, OSD officials told us that in a handful of cases, the services have invested in developers that were currently operating housing privatization projects and which have retrofitted a new set of installations into their existing ownership structures. However, they stated that the methodology for calculating the investment limitation in such a retrofitted model is the same as that for calculating the investment for projects that combine work at multiple installations before award. Although DOD provides notification and justification of its cash investments,¹⁴ and Army officials told us that they have briefed some congressional staff members on Army's new practice of retrofitting projects, DOD has not provided detailed information to Congress about its use of the retrofitting model in its semiannual report. We recognize the difficulty of the challenge DOD is facing and the importance of providing adequate housing under compressed time and investment constraints. Nevertheless, for Congress to maintain oversight of the housing privatization program, the House Report accompanying the Military Quality of Life and Veterans Affairs, and Related Agencies Appropriations Bill of 2006 directed DOD to report on the status of each

¹⁴ While Section 2875(e) of Title 10, U.S. Code, requires that the services provide written notice and justification of any cash investments made in a developer operating a military housing privatization project to Congress, these notices do not provide detailed information about the retrofitting or integration of projects.

privatization project underway, on a no less than semiannual basis.¹⁵ DOD's most recent semiannual report to the congressional defense committees did not include information on the retrofitting model. Although several retrofitting efforts are currently underway, and DOD officials have told us that they plan to retrofit additional projects in the future, it is unclear whether DOD plans to include such information in future semiannual reports. Including information about the changed status of projects that have been retrofitted, as the congressional defense committees have requested, would assist congressional oversight of the program.

Collectively, although these measures mean more appropriated funds will be spent to meet family housing needs than originally anticipated when military housing privatization projects were awarded, these funds are still far less than anticipated when Congress authorized the Military Housing Privatization Initiative. For example, at the inception of the program, DOD expected that the ratio of private funds to DOD funds invested in the initiative would be a minimum of 3 to 1—meaning for every \$3 of private funds invested into these privatization deals, DOD would invest \$1. However, at the time of our review, the overall ratio was actually 9 to 1—meaning for every \$9 of private funds invested, DOD had invested \$1. According to Army officials, even with the Army's approach of retrofitting projects in order to invest more appropriated funds to meet new military personnel growth demands at certain installations, the current 9 to 1 investment ratio is not expected to change substantially.

DOD has also taken other measures to better ensure military servicemembers and their families have adequate and affordable housing, given increases in family housing requirements at certain growth installations. For example, the Army is renovating some of its Section 801 Build-to-Lease¹⁶ housing even though the 20-year leases on these homes are expiring. Officials at Fort Drum, New York, told us that although the

¹⁵ H.R. Rep. No. 109-95, pg. 25 (2005).

¹⁶ "Section 801" housing projects were originally authorized by the Military Construction Authorization Act, 1984, Pub. L. No. 98-115 § 801 (1983), which granted temporary authority to DOD to enter into long-term leases of family housing when this approach is more cost-effective when compared to alternative means of furnishing the same housing facilities. The temporary authority was made permanent by Section 2806(a)(1) of Pub. L. No. 102-190 (1991) and is codified as amended at 10 U.S.C. 2835. Starting in 1987, the Army leased family housing units from private sector developers for 20 years with the units being assigned as military housing to Army families.

Army's remaining Section 801 leases are expected to expire in 2010, they are nonetheless repairing some of their remaining Section 801 housing to improve the condition of these homes for current and incoming junior enlisted servicemembers to meet the current shortage of adequate housing in the community surrounding Fort Drum. Further, in the President's budget presentation to Congress, Army explained its intent to temporarily use the domestic leasing program,¹⁷ if necessary, at five Army installations that are expecting to grow in military end strength and have housing privatization projects—Fort Carson, Colorado; Fort Wainwright, Alaska; Fort Drum, New York; Fort Bliss, Texas; and Fort Riley, Kansas. According to the Army, the planned use of domestic leases at these installations will continue until local housing markets, including privatized housing, are adequate to keep pace with the Army's planned growth. The domestic lease program is already being implemented at Fort Drum, New York. Finally, at some locations the Army is extending the use of the temporary lodging expense allowance. Specifically, Fort Drum officials told us they received permission to extend temporary lodging expenses up to 60 days, as opposed to the normal 30 days, to provide temporary housing at local hotels for incoming military members while they search and make arrangements for family housing.

Current Turmoil in Financial Markets Has Reduced Available Construction Funding for Some Privatization Projects

Several factors related to the current turmoil in the financial markets have reduced available funds for home construction, resulting in a larger proportion of renovations relative to new construction and reduced scope and amenities at some military family housing privatization projects. First, obtaining financing has become more expensive. Second, more funds now need to be set aside to help ensure debt repayment. Third, lower return rates are now occurring on invested funds.

¹⁷ The domestic leasing program provides temporary housing for military families pending availability of permanent housing through DOD payment of rent, and operating and maintenance costs of privately-owned houses that are assigned to military families as government quarters.

Newly Awarded Projects Have Less Funds Available for Construction Because Obtaining Financing Has Become More Expensive

Higher interest rates have increased the costs that some developers had to pay at the time of our review to obtain financing from newly obtained bonds, thus reducing the funds available for construction. In such circumstances the services have had to reduce the number of new homes to be constructed in favor of doing more renovations, which are generally less costly. For example, a representative with the Hunt Development Group, which is developing the Army's Fort Lee project in Virginia, told us that when the project went to financial closing, the amount of principal the developer was eligible to borrow was reduced by \$10 million because of increased interest costs to obtain bond financing. As a result, the Army authorized the developer to build 97 fewer new homes. The developer told us that it probably could have borrowed an additional \$10 million, but the Army would not allow it to do so due to the potential long-term financial strain it could put on the project. In doing so, the Army stated that they, the underwriter, and the developer applied standard conservative underwriting principles to the Fort Lee project financing to help ensure long-term success of the project.

Although higher interest rates have added to the cost of certain projects, in one case the respective service was able to find additional sources of income to offset increased interest costs in order to maintain the original number of new homes. Specifically, according to Air Force officials, when the developer of the Air Mobility Command West project (consisting of Fairchild Air Force Base, Washington; Tinker Air Force Base, Oklahoma; and Travis Air Force Base, California) went to financial closing in July 2008, the amount of principal the developer was eligible to borrow was reduced by about \$18.5 million because of an unanticipated increase in interest costs. However, the Air Force did not reduce the number of new homes to be built because, according to Air Force officials, they and the developer were able to offset higher interest costs by reducing expenses through the negotiation of tax relief from the local jurisdictions and by the Air Force demolishing some houses using its own operation and maintenance funds, although the demolition had the effect of increasing the use of appropriated funds to complete the project.

Newly Awarded Projects Have Less Funds Available for Construction Because Funds Now Need to be Set Aside to Help Ensure Debt Repayment

Due to the credit rating downgrades of firms that insure bonds, alternatives to cash funding are no longer available to satisfy debt service reserve requirements which are causing developers to have to set aside cash in reserves to help provide assurances that the project's debt will be repaid in the event the developer cannot make debt payments. This in turn is reducing the amount of funds available for construction, according to defense officials. Traditionally, the services and housing privatization

developers have used bond insurance to obtain lower interest rates and to make the bonds more marketable because of the added protection of repayment the insurance provides. For a fee, bond insurers such as American International Group (AIG), Municipal Bond Investors Assurance (MBIA), or American Municipal Bond Assurance Corporation (AMBAC) guarantee the timely payment of principal and interest on the bonds if the privatization project cannot make debt payments. Central to the business strategy of the bond insurers is the companies' triple-A credit ratings,¹⁸ which help give the bonds they insure higher ratings. For privatization projects, higher ratings on bonds reduce borrowing costs due to investors offering lower interest rates, making the bonds more marketable because principal and interest payments are guaranteed. However, because many of the bond insurers have financial investments that have fallen in value, with some tied to troubled subprime mortgages, credit rating agencies have currently downgraded the credit ratings of these firms. As a result, for some projects it is no longer cost effective to carry bond insurance because it either does not result in lower interest rates or rates low enough to cover the costs associated with the insurance. However, if a developer does not purchase bond insurance for its project, then investors normally require it to maintain cash in reserve for debt payments—usually enough to cover 6 to 12 months of debt payments—making less money available for construction. For example, both higher interest rates to borrow funds and the requirement to cash fund the debt service reserve due to the diminished value of bond insurance have impacted the Army's Fort Jackson, South Carolina, privatization project. In this case, the Army agreed to allow the developer to reduce the number of planned renovations resulting in these homes receiving no work.

Additionally, because many developers for ongoing privatization projects use bond insurance, the diminished value of bond insurance could cause financial stress for these projects if investors require developers to set aside cash reserves to provide greater assurance of repayment of the debt. Although the services told us they believe bond investors will not require ongoing projects to set aside cash for debt repayment of the current phase of the project, Navy officials did say that investors could potentially use

¹⁸ Issued by the three major credit rating agencies—Standard & Poor's, Fitch Group, and Moody's Investor Services—credit ratings are intended to provide an opinion on the relative ability of an entity to meet financial commitments, such as interest, dividends, repayment of principal, or insurance claims. Investors have used credit ratings as indications of the likelihood of receiving their money back in accordance with the terms on which they invested.

this requirement as leverage when developers try to obtain financing for additional phases of a project. That is, investors may require the developer to set aside cash for debt repayment for projects already started or completed as a condition for receiving funding for additional project phases.

Newly Awarded Projects Have Less Funds Available for Construction Because of Lower Return Rates on Invested Funds

The turmoil in the financial markets also has resulted in lower rates of return on invested funds, leading to less earned interest on invested project funds. Since developers use interest earnings to help finance project construction (in addition to money borrowed in private capital financial markets and military service-provided money), lower rates of return on investment mean that the developers will have less funds available to pay project expenses. As a consequence, the services have in turn modified their construction plans for certain projects. In many cases, developers invested project funds in long-term investments with financial service firms and bond insurers that were considered relatively safe at the time. Subsequently, however, these firms have suffered financial difficulties and credit rating downgrades due to their investments in subprime mortgages. Although we were told that investment agreements between the projects and these firms usually have protection clauses giving the project developer the right to withdraw funds due to rating downgrades of the financial services firms, sometimes the funds have had to be reinvested in other investment accounts with firms that are offering lower rates of return, resulting in reduced investment income to the developer. According to service officials, for some projects this is not an issue because the investment agreement has a “make whole” provision, meaning the financial services firm in which the funds were invested is not only obligated to return the invested funds to the project but also to pay the project for the difference in potential interest earnings. However, service officials said that some project investment agreements do not have “make whole” provisions— meaning the financial services firm in which the funds were invested is only obligated to return the invested funds and does not have to pay for the difference in potential interest earnings. As a result, such projects receive less interest earnings.

Since interest earnings is one of the sources of revenue that provide income to the project to pay for operations, construction, and future recapitalization, lower-than-anticipated interest earnings can affect the financial health of a project, and in some projects, amenities such as community centers could be eliminated. For example, the Air Force is projecting a revenue shortfall for its Tri-Group family housing privatization project comprised of Los Angeles Air Force Base, California; Peterson Air

Force Base, Colorado; and Schriever Air Force Base, Colorado, due to the difference in return rates on invested funds. As a result, the Air Force is negotiating with the developer a number of changes such as eliminating two community centers and some new housing to offset the lower-than-anticipated investment earnings. Similarly, Navy officials told us that their family housing privatization project in Hawaii could potentially have a \$25 million to \$30 million revenue shortfall due to reduced rates of return on investments; however, Navy does not anticipate reducing the amount of new construction or amenities in the project. According to the Navy, although project funds are now placed in more conservative but lower yielding investments, decreases in interest earnings have thus far been offset by project savings. Such changes in the size, mix of new construction and renovations, or content of privatized military housing projects could have an impact on the financial health of projects since renovated homes might require increased maintenance and earlier replacement as compared to newly constructed homes. Moreover, in some circumstances, renovated homes, combined with fewer project amenities, could make the houses less marketable if off-base housing from a competing developer is seen as more desirable by servicemembers and their families.

Collectively, a decline in available construction funds caused by higher interest rates, increased debt repayment reserve requirements, and lower rates of return on invested funds could have an adverse impact on the condition and amenities of military housing privatization projects, which could in turn reduce occupancy, and ultimately threaten the financial viability of those projects. Over the past few years several congressional committees have indicated interest in the military housing privatization program.¹⁹ Further, a House Conference Report directed DOD to include data on developers' contributions to the recapitalization accounts of each ongoing family housing privatization project in each semiannual report on the privatization program,²⁰ and the House Appropriations Committee has directed DOD to provide a semiannual report summarizing the results of DOD's military housing privatization initiative monitoring tool and giving status reports on each privatization project underway.²¹ As more homes

¹⁹ See, e.g., H.R. Conf. Rep. No. 110-424, pg. 443 (2007); S. Rep. No. 109-286, pg. 27 (2006); and S. Rep. No. 108-82, pg. 35 (2004).

²⁰ H.R. Conf. Rep. No. 110-424, pg. 443 (2007).

²¹ H.R. Rep. No. 109-95, pg. 25 (2005).

are renovated rather than constructed anew, privatization projects with a large number of renovations will require more recapitalization funds than would otherwise have been the case given the effects of the current turmoil in financial markets. However, information about the impact that the recent turmoil in the financial markets is having on some projects and the resulting effects on available funds for new construction as well as on future recapitalization funds was not included in DOD's most recent semiannual status report to the congressional defense committees in January 2009. By including this information on housing privatization projects in its semiannual report, DOD could provide Congress with a more current view of the effects of the current financial market and enhance congressional defense committees' ability to monitor the services' efforts to provide servicemember with quality housing over the life of each project.

Conclusions

DOD is implementing or is planning to implement several significant initiatives, such as increasing the services' force structure by tens of thousands of personnel, that will increase the number of military servicemembers and their families who will need adequate and affordable family housing. Although DOD is taking several measures to ensure adequate housing exists at its installations, it still faces challenges that could result in insufficient housing at some installations expecting significant increases in military families over the next several years. Including information about the changed status of retrofitted projects would assist congressional oversight of the program.

By enacting the Military Housing Privatization Initiative, Congress provided DOD with a variety of authorities to obtain private sector financing as a way to eliminate its inventory of inadequate and poor quality family housing. This initiative brings private sector financing, business practices, and certain flexibility to help ensure that DOD can provide housing to military families when needed. However, privatization is essentially a business venture, and like any business, it carries inherent risk. If the increase in renovated houses over new construction due to turmoil in the financial markets continues to increase the demand for recapitalization funds over the life of the project, developers may not be able to sustain projects in a way that ensures adequate quality of life for military servicemembers and their families. According to DOD, decent and affordable housing is one of the most important factors in its ability to retain a professional force and maintain readiness. Informing Congress about the long-term financial health of recapitalization accounts for family housing privatization projects will give it a more current view of the

services' efforts to provide servicemembers with quality housing over the life of each project. Timely information on the effects of the current financial markets on housing privatization projects—such as in DOD's semiannual status report on housing privatization program—could, if necessary, help congressional decision makers prevent a return to the poor military housing conditions that led DOD to request congressional authority to pursue the Military Housing Privatization Initiative over a decade ago.

Recommendations for Executive Action

For Congress to maintain oversight of the Military Housing Privatization Initiative program, we recommend that the Secretary of Defense direct the Under Secretary of Defense (Acquisition, Technology and Logistics) to include, for each project that is retrofitted, an explanation of this practice and information on DOD's total investment in the retrofitted project in its semiannual status report to the congressional defense committees.

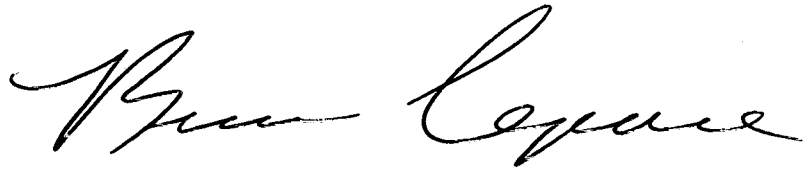
To better inform Congress about the financial market factors that could affect the privatized military family housing program's financial health and to enhance congressional oversight, we recommend that the Secretary of Defense direct the Under Secretary of Defense (Acquisition, Technology and Logistics) to include information in its semiannual report to the congressional defense committees on the effects current conditions in the financial markets are having on housing privatization projects.

Agency Comments and Our Evaluation

In written comments on a draft of this report, DOD concurred with our recommendations saying that including information on both the practice of "retrofitting" or "integrating" projects and the effects current conditions in the financial markets are having on privatization projects in the Department's semiannual Program Evaluation Plan Report to Congress would enhance Congressional oversight of the privatization program. DOD's comments are reprinted in appendix II. DOD further provided technical comments, which we incorporated as appropriate into this report.

We are sending copies of this report to interested congressional committees; the Secretary of Defense; the secretaries of the Army, Navy, and Air Force; and the Commandant of the Marine Corps. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff has any questions concerning this report, please contact me on (202) 512-4523 or by e-mail at leporeb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs are on the last page of this report. Key contributors to this report are listed in appendix III.

A handwritten signature in black ink, reading "Brian Lepore". The signature is fluid and cursive, with the first name "Brian" and last name "Lepore" clearly distinguishable.

Brian J. Lepore, Director
Defense Capabilities and Management

Appendix I: Scope and Methodology

We performed our work at the Office of the Secretary of Defense and the offices of the Army, Navy, Marine Corps, and Air Force responsible for implementing the housing privatization program. We reviewed relevant documentation including the Department of Defense (DOD) and service guidance on the implementation of the Military Housing Privatization Initiative, project progress and performance reports developed by the services, and prior GAO reports. We also interviewed officials at the Air Force’s Center for Engineering and the Environment in San Antonio, Texas, which is designated as the Air Force’s military family housing privatization center of excellence. In each instance, we met with officials cognizant of the program and reviewed applicable policies, procedures, and documents. Further, we visited 13 selected military installations with housing privatization projects to review project management at the local level, examine project performance, and determine from installation officials and private sector developers the challenges they face in managing their military housing privatization projects. Table 4 lists the installations we visited.

Table 4: Installations Visited during Our Review

Army	Navy and Marine Corps	Air Force
Fort Bliss, Texas	Marine Corps Base Camp Pendleton, California	Holloman Air Force Base, New Mexico
Fort Drum, New York	Navy’s San Diego Complex, California	Joint Base McGuire-Dix-Lakehurst, New Jersey
Fort Lee, Virginia		Little Rock Air Force Base, Arkansas
Joint Base Lewis-McChord, Washington		Moody Air Force Base, Georgia
Fort Meade, Maryland		
US Army Garrison Presidio of Monterey, California		
White Sands Missile Range, New Mexico		

Source: GAO.

Together the installations contained 12 separate military housing privatization projects, since Fort Bliss and White Sands Missile Range are included in the same project. At each installation we spoke with service officials managing the family housing privatization project. We also spoke with representatives from the private sector developers in charge of constructing and managing these projects. We chose these installations because they contained already awarded projects, represented each of the military services, and provided a balance of projects with and without challenges. Additionally, we choose Fort Bliss, White Sands, and Camp

Pendleton as installations to visit because they are expected to experience a significant influx of military servicemembers and their families due to the planned implementation of DOD's Grow-the-Force initiative. Joint Base McGuire-Dix-Lakehurst and Joint Base Lewis-McChord were selected primarily because they are 2 of 12 joint bases established by the 2005 Base Realignment and Closure round with Joint Base McGuire-Dix-Lakehurst being managed by the Air Force and Joint Base Lewis-McChord being managed by the Army. Our analysis of the 13 installations we visited cannot be generalized to other military housing privatization projects.

To assess the progress of DOD's housing privatization efforts we obtained and analyzed performance data on each of DOD's privatization projects. Specifically, to determine the number of units privatized we obtained data on the number of projects awarded from OSD's Web site and received estimated data on the number of units expected to be privatized from the services. We obtained construction and renovation data from OSD and the services through February 2009. Although we did not independently validate the construction or renovation data supplied by OSD and the services, we did however compare this data to the data in OSD's semiannual report to Congress and the services' program performance reports. We also discussed with officials steps they have taken to ensure reasonable adequacy of the data. As such, we determined the data to be sufficiently reliable for the purposes of this report.

To assess occupancy rates, we interviewed DOD and service officials to discuss project occupancy expectations, the factors that contribute to lower-than-expected occupancy rates, the financial and other impacts that result from lower-than-expected occupancy rates, and the responses normally taken when occupancy is below expectations. We obtained, reviewed, and analyzed project occupancy rates and trends for all privatization projects awarded as of September 30, 2008, the last quarter for which occupancy data from all three military departments were readily available, and compared these data to occupancy expectations. We did not collect data for two recently awarded Army projects—Fort Sill, Oklahoma, and Joint Base Lewis-McChord, Washington—because data were not yet available. Also, for the 12 projects at the installations we visited, we reviewed project justification and budget documents to determine each project's occupancy expectations and compared actual occupancy rates with the expectations. When occupancy rates were below expectations, we reviewed project performance reports and interviewed local officials to determine the causes, consequences, and any actions taken or planned in response.

To identify challenges to the military housing privatization program stemming from DOD's recent force structure and infrastructure initiatives, we conducted numerous interviews with OSD, the services, and installation commanders. In these discussions we identified the challenges officials said these initiatives were creating for them in providing sufficient and affordable privatized housing and noted some measures they had taken to mitigate those challenges. In addition, we collected and analyzed the most recent housing market analyses for privatization projects on installations expected to experience significant growth to determine the extent to which family housing requirements were expected to increase. Finally, we collected and analyzed relevant guidance and documentation regarding the measures taken by the services to incorporate increased requirements into their housing privatization projects, specifically the retrofitting of already awarded projects by the Army. As such, we obtained the legal views of the Office of the Secretary of Defense, Department of the Army, and Department of the Navy regarding the implementation of section 2875 of Title 10, U.S. Code.

To assess the effect the turmoil in the financial markets is having on DOD's housing privatization portfolio, we interviewed officials from each service and collected and analyzed internal service quarterly portfolio summary reports and analyses. In addition, we interviewed representatives from the Army and Air Force's real estate development consultants to further understand the dynamics of the financial markets and how those dynamics are affecting housing privatization projects. Service officials identified some newly awarded projects that were more affected by market turmoil than others. For those projects, we interviewed service officials and consultant representatives to determine the causes, consequences, and any actions taken or planned in response. We also reviewed service and OSD project performance reports, such as the semiannual program evaluation plan, to determine the extent to which DOD is reporting impacts of the financial markets on its housing privatization projects to Congress. Further, we attended a bond industry conference on the financing of military housing privatization to learn the views of the investment community regarding the impacts of the financial market turmoil on housing privatization projects and obtained and reviewed private sector financial analyses and reports regarding military housing bonds and the current state of the financial markets.

We conducted this performance audit from April 2008 to April 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings based

on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings based on our audit objectives.

Appendix II: Comments from the Department of Defense



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

MAY 08 2009

Mr. Brian Lepore
Director, Defense Capabilities and Management
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Lepore:

This is the Department of Defense (DoD) response to the GAO draft report, GAO-09-352, "MILITARY HOUSING PRIVATIZATION: DoD Faces New Challenges due to Significant Growth at Some Installations and Recent Turmoil in the Financial Markets," April 10, 2009, (GAO CODE 351107). Detailed comments on the report recommendations are enclosed.

The Department appreciates the opportunity to comment on the report.

Sincerely,

Wayne Army
Deputy Under Secretary of Defense
(Installations and Environment)

Enclosure:
As stated



GAO DRAFT REPORT - DATED APRIL 10, 2009
MILITARY HOUSING PRIVATIZATION: DoD Faces New Challenges due to Significant
Growth at Some Installations and Recent Turmoil in the Financial Markets
GAO CODE 351107/GAO-09-352

**DEPARTMENT OF DEFENSE COMMENTS
TO THE RECOMMENDATIONS**

RECOMMENDATION 1: The GAO recommends that the Secretary of Defense direct the Under Secretary of Defense (Acquisition, Technology and Logistics) to include, for each project that is retrofitted, an explanation of this practice and information on DoD's total investment into the retrofitted project in its semi-annual status report to the congressional defense committees. (p. 45/GAO Draft Report)

DOD RESPONSE: Concur. DoD agrees that information regarding privatized housing projects which have been integrated or merged into existing ownership structures and an explanation of this practice by the Military Departments should be included in the Department's semi-annual Program Evaluation Plan Report to Congress. This information would enhance Congressional oversight of the military housing privatization program by highlighting and explaining the integration of privatization projects that share a common private developer/owner.

RECOMMENDATION 2: The GAO recommends that the Secretary of Defense direct the Under Secretary of Defense (Acquisition, Technology and Logistics) to include information in its semi-annual report to the congressional defense committees on the effects of the current financial markets on newly-awarded projects. (pgs. 45-46/GAO Draft Report)

DOD RESPONSE: Concur. DoD agrees that information on the effects of the current financial markets on newly-awarded projects should be included in the Department's semi-annual Program Evaluation Plan Report to Congress. This information would enhance Congressional oversight of the military housing privatization program, by providing Congress better information about how financial market factors affect project finances across the privatized military housing portfolio.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Brian J. Lepore, (202) 512-4523 or leporeb@gao.gov

Acknowledgments

In addition to the individual named above, Laura Talbott (Assistant Director), Shawn Arbogast, Steven Banovac, Susan Ditto, George Duncan, Laurie Ellington, Katherine Lenane, Charles Perdue, Mathew Scire, and Steven Westley made key contributions to this report.

Related GAO Products

Military Housing Privatization

Military Housing: Management Issues Require Attention as the Privatization Program Matures. [GAO-06-438](#). Washington, D.C.: April 28, 2006.

Military Housing: Further Improvements Needed in Requirements Determination and Program Review. [GAO-04-556](#). Washington, D.C.: May 19, 2004.

Military Housing: Better Reporting Needed on the Status of the Privatization Program and the Costs of Its Consultants. [GAO-04-111](#). Washington, D.C.: October 9, 2003.

Military Housing: Management Improvements Needed as the Pace of Privatization Quickens. [GAO-02-624](#). Washington, D.C.: June 21, 2002.

Military Housing: DOD Needs to Address Long-Standing Requirements Determination Problems. [GAO-01-889](#). Washington, D.C.: August 3, 2001.

Military Housing: Continued Concerns in Implementing the Privatization Initiative. [GAO/NSIAD-00-71](#). Washington, D.C.: March 30, 2000.

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Financial Markets

Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues. [GAO-09-296](#). Washington, D.C.: January 30, 2009.

High Risk Series Update. [GAO-09-271](#). Washington, D.C.: January 2009.

Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System. [GAO-09-216](#). Washington, D.C.: January 8, 2009.

Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency. [GAO-09-266T](#). Washington, D.C.: December 10, 2008.

Related GAO Products

Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency. [GAO-09-161](#). Washington, D.C.: December 2, 2008.

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